

# Intellectual Property

2007 SPRING BULLETIN

## Supreme Court in *MedImmune* Opens the Courthouse Doors to Licensees Who Challenge the Scope or Validity of Licensed Patents

BY LIWEN A. MAH

The Supreme Court has ruled that patent licensees do not need to breach their license agreements before seeking a declaratory judgment in federal court that the underlying patent is invalid, unenforceable, or not infringed. *MedImmune v. Genentech*, No. 05-608 (Jan. 9, 2007). The Court displayed its continued unwillingness to defer to the Federal Circuit and signaled a practical approach regarding challenges to patents. For patentees and licensees, *MedImmune* calls for extra care in drafting licensing agreements to clearly define licensees' rights to challenge the underlying patents.

### A controversy may exist even without threat of suit

In this case, Genentech asserted that a respiratory drug product from MedImmune infringed its patent. MedImmune denied liability but ultimately agreed to take a license from Genentech. Although MedImmune continued to pay royalties pursuant to its license agreement, it filed a declaratory judgment action arguing that Genentech was not entitled to royalties because the asserted patent was invalid, unenforceable, or not infringed.

Genentech moved to dismiss the lawsuit for lack of subject matter jurisdiction, since federal courts cannot issue advisory opinions and have jurisdiction only where there is an actual controversy and cannot issue advisory opinions. In prior cases with similar facts, the Federal Circuit had found no controversy existed because a licensee in good standing cannot have any reasonable apprehension of being sued for infringement by the patentee. Accordingly, the Federal Circuit dismissed MedImmune's challenge.

In an 8–1 decision, the Supreme Court ruled that an actual controversy existed. While MedImmune had contractually agreed to pay the royalties regardless of the patent's validity, the Court stated that agreeing to pay a royalty "until a patent claim has been held invalid by a competent body" does not prevent a licensee from questioning the patent's validity.

Moreover, the Court noted that there was no legal or practical reason to require a licensee to breach the license agreement—exposing the licensee to liability or causing damages—before seeking a declaratory judgment regarding that license agreement. Previously, in *Altwater v. Freeman*, 319 U.S. 359 (1943), the Court had allowed patent licensees who had paid royalties "under protest" to seek a declaratory judgment about the patent's validity. Signing a license agreement under protest creates a controversy "where payment of a claim is demanded as of right and where payment is made, but where the involuntary or coercive nature of the exaction preserves the right to recover the sums paid or to challenge the legality of the claim." However, in the Federal Circuit case, the court distinguished *Altwater* as applicable

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only when the “involuntary or coercive nature” arises from an injunction or governmental compulsion.

Writing for the majority of the Court, Justice Scalia disagreed, stating that *Altwater’s* facts did not require such a narrow rule. “The rule that a plaintiff must destroy a large building, bet the farm, or (as here) risk treble damages and the loss of 80 percent of its business, before seeking a declaration of its actively contested legal rights finds no support” in the Constitution’s jurisdictional requirements for federal courts. This comment is particularly notable because Justice Scalia, who has authored some of the Court’s major decisions on justiciability, has written that federal jurisdiction requires the existence of an injury to a legally protected interest that is not conjectural or hypothetical. In *MedImmune*, Justice Scalia stated that MedImmune’s prospective injury was not merely conjectural or hypothetical, even though Genentech had never threatened to sue its licensee in the absence of a license agreement.

#### **Licensees now have more leverage, and patentees will need to negotiate harder for covenants not to sue**

As a result, patentees now have much less leverage over licensees who have not admitted the validity, enforceability, or infringement of the licensed patents. In his dissent, Justice Thomas argued that MedImmune entered into the license agreement and paid the royalties, and that the majority was thus wrong to interfere with “voluntarily accepted contractual obligations between private parties.” Genentech argued that licensing is a voluntary agreement whereby a licensee gains immunity from infringement suits in exchange for royalties and a waiver of any right to challenge the underlying patent. Furthermore, the license agreement required MedImmune to pay royalties until a patent claim was held invalid by a competent body.

The majority, however, disagreed with these arguments and echoed the decision in *Lear, Inc. v. Adkins*, 395 U.S. 653 (1969). *Lear* held that a licensee is not estopped from challenging a patent despite an agreement to pay royalties until a patent is held invalid. The rationale of *Lear* is that public policy favors “full and free competition in the use of ideas,” so licensees should have a prerogative to challenge a patent. After *MedImmune*, courts are unlikely to infer from a license agreement that a licensee has waived the

right to sue over the scope or validity of the licensed patent.

Patentees thus should carefully consider whether to grant a license without an express covenant not to sue. Under the license in *MedImmune*, Genentech could not sue MedImmune for infringement so long as MedImmune paid its royalties and was in good standing. This gave MedImmune the option to decide when and where to challenge the patent in federal court. Because of this asymmetry in the ability to sue once a license is in place, a patentee may be better off initiating an infringement suit in lieu of licensing if infringement is believed to be present by the potential licensee. However, the higher costs associated with litigation are likely to play a major role in the feasibility of such a decision. Alternatively, a patentee might consider a more complex and robust licensing agreement.

As is common in intellectual property cases, the decision here raises new areas of uncertainty at the same time as it resolves other issues. It appears that some time will be needed before we can determine the extent to which the right of private contract will be allowed to prevail over the doctrine supporting a licensee’s right to challenge a patent. In addition, patent owners may pressure Congress to address the above-noted asymmetry.

#### **Congressional Balancing Act: The Trademark Dilution Revision Act of 2006**

BY SALLY M. ABEL

U.S. trademark law took another significant step forward in 2006 with the enactment of the long awaited, much debated amendments to the Federal Trademark Dilution Act (FTDA). On October 6, 2006, President Bush signed the Trademark Dilution Revision Act (the Act) into law, effective immediately (Lanham Act § 43(c); 15 U.S.C.

§ 1125(c)). The Act clarifies and more carefully defines the scope of U.S. federal anti-dilution law than the FTDA had, speaking to virtually every substantive dilution issue the courts had wrestled with during the FTDA’s relatively short life. A bit of history sets the stage.

The FTDA, effective January 16, 1996, and consistent with traditional notions of dilution protection, afforded owners of famous marks a remedy for the dilution of those marks

occurring after the mark in question became famous, even in the absence of a likelihood of confusion between the owner's use of the mark and another's use of the same or similar mark or name. While this approach was consistent with the language of the Model State Trademark Law, adopted by approximately half of the states since 1965, the language of the FTDA departed from the Model State language in several telling respects, including defining dilution as "the lessening of the capacity of a famous mark to identify and distinguish" and in requiring that the trademark use challenged must "cause dilution of the distinctive quality of the mark."

The definition of dilution contained in the FTDA, and its departure from the Model State language, caused much consternation within several federal courts of appeals. *Ringling Brothers-Barnum & Bailey Combined Shows, Inc. v. Utah Division of Travel Development*, 170 F.3d 449 (4th Cir. 1999), is a prime example of that phenomenon. In *Ringling Brothers* the Fourth Circuit Court of Appeals had the unenviable task of interpreting the fairly new FTDA in a difficult context: the State of Utah had been using "GREATEST SNOW ON EARTH" as its state motto, including emblazoning it on every vehicle license plate in the state, for more than 30 years before the FTDA became law and Ringling Brothers brought suit claiming that the slogan violated its well-known "GREATEST SHOW ON EARTH" mark. Not surprisingly, the Fourth Circuit ruled in favor of Utah, going out of its way to interpret the statutory language as requiring "actual dilution," while at the same time acknowledging that "[t]he difficulties of proving actual dilution by practically available means is evident."

Subsequently, in *Nabisco, Inc. v. PF Brands, Inc.*, 191 F.3d 208 (2d Cir. 1999), the Second Circuit upheld the lower court's grant of a preliminary injunction against Nabisco's distribution of a fish-shaped cheddar-flavored cracker. The Second Circuit took issue with the *Ringling Brothers* court's statutory interpretation, accusing the Fourth Circuit of engaging in "excessive literalism to defeat the intent of the statute." As time went on, other courts chimed in on one side or the other, and the issue was ripe for the Supreme Court's decision in *Moseley v. V Secret Catalogue, Inc.*, 537 U.S. 418 (2003).

The *Moseley* Court sided with the Fourth Circuit, holding that the plain language of the statute required proof of actual injury to the economic value of a famous mark,

rather than the mere "likelihood of dilution" that would be required under most state dilution laws. However, the Supreme Court parted company with the Fourth Circuit on whether actual economic loss need be established, opining that proof of such loss was not required. The decision also was noteworthy for the Court's comment, arguably in dicta, that dilution by tarnishment, long understood as one of the two bases of a state law dilution claim, might not even be covered by the FTDA.

The Act is a direct response to the *Moseley* decision; the arguably vague, open-ended language of the FTDA is no more. The Act effectively overturns *Moseley*, establishing an explicit "likelihood of dilution" standard, applicable both in cases of blurring and tarnishment: the owner of a famous mark is entitled to an injunction against a use in commerce occurring after the mark became famous (not a change from the FTDA) "that is likely to cause dilution by blurring or dilution by tarnishment of the famous mark, regardless of the presence or absence of actual or likely confusion, of competition, or of actual economic injury."

To underscore its intent, and to provide greater guidance to the courts than had been proffered in the earlier statutory language, Congress went on to further define the two categories of dilution. Dilution by blurring now is defined as "[a]ssociation arising from the similarity between a mark or trade name and a famous mark that impairs the distinctiveness of the famous mark." Tarnishment, by contrast, is defined as "[a]ssociation arising from the similarity between a mark or trade name and a famous mark that harms the reputation of the famous mark." The statute contains a list of nonexclusive factors by which a court may assess whether dilution by blurring is present, but contains no similar list for dilution by tarnishment. Perhaps the standard for what constitutes tarnishment, like the standard for identifying pornography, defies precise definition, and the "I'll know it when I see it" approach applies.

In another nod to trademark owners, the Act also clarifies that dilution protection is available to all famous marks that are distinctive, whether "inherently or through acquired distinctiveness." One would have thought that such elucidation was unnecessary, as a truly famous "mark," by definition, necessarily would be distinctive as that concept has been understood and embraced for years

in trademark jurisprudence. However, the amendment was necessitated by the Second Circuit's rather tortured interpretation of the FTDA in *TCPIP Holding Co. v. Haar Communs.*, 244 F.3d 88 (2nd Cir. 2001), in which the Second Circuit held that the FTDA applied only to inherently distinctive marks.

Both the reformulation of the definition of dilution and the language defining distinctiveness suggest that Congress intended to broaden the scope of available dilution protection. But, in fact, Congress imposed other restrictions appropriately calculated to balance trademark owners' rights with other commercial interests and free-speech considerations. For example, in addition to arguably making it easier for the owner of a famous mark to establish dilution, the Act also makes it harder for a trademark owner to prove that its mark is indeed famous.

The Act clarifies an open question under the FTDA: niche fame is not sufficient to establish fame under the Act. To establish that a mark is famous, the trademark owner must prove that the mark is "widely recognized by the general consuming public of the United States as a designation of source of the goods or services of the mark's owner." This requirement will significantly limit the number of marks entitled to relief under the Act.

In addition, the Act expressly cordons off certain behavior as "not actionable." This includes all non-commercial use of a mark and news reporting. Likewise, the exclusion extends to "any fair use...by another person other than as a designation of source for the person's own goods or services." Such fair use extends to "nominative or descriptive fair use," comparative advertising, and "identifying and parodying, criticizing, or commenting upon the famous mark owner or the goods or services of the famous mark owner."

As with any new law, there will be disputes requiring interpretation of the Act. Such litigation may well focus on the breadth of the exemptions under the law. For example, as indicated, the Act specifies that it extends to dilution by either blurring or tarnishment, defining the latter as use "that harms the reputation of the famous mark." Under the Act, tarnishment is actionable, parody expressly is not. However, what is tarnishment in the eyes of an offended trademark owner may in fact be parody in the eyes of the challenged user. Where, and in what procedural context,

courts will draw the line remains to be seen. We do know that noncommercial use of a mark also is exempt from liability under the Act, so unquestionably noncommercial parody is immune. Parody is generally understood to be poking fun at someone else's trademark in a way that simultaneously conveys conflicting messages: that the use is of the parodied mark and, at the same time, that it is not.

Questions of whether particular uses fall within one category or another—tarnishment or parody, commercial or non-commercial use—will continue to find their way to the courts in dilution cases, as they continue to do in the more traditional infringement and unfair competition contexts. However, the balance Congress struck with the Act between trademarks and free speech appears to be a sound one, limiting dilution protection to truly famous marks with national renown, and then only in limited contexts not impeding legitimate free speech.

### **Audio Home Recording Act Does Not Protect Device Distributor Against Copyright Claims Arising From Broadcaster Role**

BY MITCHELL ZIMMERMAN

In a case of first impression, a New York district court held that the Audio Home Recording Act, 17 U.S.C. §§ 1001 *et seq.* (AHRA), does not immunize a distributor of digital audio recording devices from copyright liability when the infringement claims are based on the distributor's allegedly infringing activity in its simultaneous role as a satellite radio broadcaster. The case illustrates the ambiguous nature of digital transmissions, which can be treated as distributions of musical works as well as digital performances. *Atlantic Recording Corp. v. XM Satellite Radio, Inc.*, 2007 U.S. Dist. Lexis 4290 (S.D.N.Y. Jan. 19, 2007).

Defendant XM Satellite Radio operates a satellite broadcast service with some six million subscribers, operating under the compulsory statutory license scheme provided in 17 U.S.C. § 114. In connection with its broadcast services, XM also distributes special receivers marketed as "XM + MP3" players. The XM + MP3 players can do two things in addition to receiving XM broadcasts. They can store and play MP3 files the user acquires from other sources, and they can record and play back the songs that XM broadcasts. The XM + MP3 can hold about 1,000 songs,

which the user can access so long as the user continues to subscribe to the XM Satellite Radio service.

XM + MP3 users can record a broadcast song by pressing a button at any time during a broadcast. To help users find and record songs or artists, XM provides digital playlists identifying all songs broadcast over particular channels during particular periods of time. XM also offers an alert service that notifies XM + MP3 users when a particular song or music by an artist they have previously flagged is being played on any XM channel, so users can record the track.

The plaintiffs are ten record companies that own rights to the majority of copyrighted sound recordings sold in the United States. They sued XM for infringing their exclusive distribution rights under copyright law, for violating § 115's bar on unauthorized digital phonorecord delivery, for unauthorized reproduction, for violating its compulsory license, for secondary infringements relating to the foregoing, and for various other wrongs.

The compulsory license under § 114 is subject to statutory restrictions intended to ensure that satellite broadcasters operate like traditional radio broadcasters. For example, the stations cannot provide an interactive service, cannot publish their programming schedules before broadcast, and cannot play songs from the same artist or album more frequently than specified within a three hour period. Plaintiffs alleged that XM violated the scope of its license by acting as both a broadcaster and a distributor. XM asserted the AHRA as a complete defense.

The AHRA is a statutory scheme originally intended to address a technology, digital audio tape, which never took off and only a handful of cases have interpreted the law. For qualifying devices that embody appropriate technological limitations—particularly, features to preclude multiple generation digital copying—the AHRA provides immunity from copyright infringement claims. Under AHRA's complex provisions, players that download MP3 files from computers have been held not to be “digital audio recording devices” subject to the AHRA, but devices such as the XM + MP3 that make copies from broadcasts can qualify.

Section 1008 of the AHRA provides that no copyright infringement action can be brought “based on the manufacture, importation, or distribution of a digital audio recording device [DARD]...or based on the noncommercial use by a consumer of such a device...for making digital music recordings....” Relying on § 1008, XM filed a motion to dismiss. “Under XM's reading of the statute,” the district court stated, “if XM is a distributor of DARDs within the definition of the AHRA, there is no limit to the infringing conduct in which they may engage.” The court rejected that thesis and denied XM's motion.

“[U]nder a plain language analysis of the AHRA, ‘A claim is “based on” manufacture, importation or distribution of a [DARD] only where the acts of manufacturing, importing, or distributing the device is [sic] the conduct on which liability is premised.’” Put another way, XM is not being sued for actions taken in its capacity as a DARD distributor; therefore, XM is not immunized from this suit under the protection offered by the AHRA.

Since, the court reasoned, XM broadcast and stored copyrighted music for later recording by consumers, XM acted as a distributor as well as a broadcaster:

“The court finds that because of the unique circumstances of XM being both a broadcaster and a DARD distributor and [because] its access to the copyrighted music results from its license to broadcast only, that the alleged conduct of XM in making that music available for consumers to record well beyond the time when broadcast, in violation of its broadcast license, is the basis of the Complaint, and being a distributor of a DARD is not. Thus the AHRA, on these facts, provides no protection to XM merely because they are distributors of a DARD.”

Interestingly, under the court's ruling, the same actions by XM—transmitting digital musical content to end users—constitute both a digital audio performance under 17 U.S.C. § 114 and the distribution of copies under § 106 where the features of the XM+MP3 device allow subscribers to maintain copies of the works on the device. Notwithstanding that it is XM's distribution of devices with features that permit this functionality, the court held that plaintiffs' copyright claims were not “based on” XM's distribution of the XM + MP3, but on XM's making music available for subscribers to record in

a manner that violated XM's broadcast license, arguably a fine distinction.

Although fair use was not before the district court on XM's motion to dismiss, the court's discussion strongly suggested that XM would fare ill on that defense. Expressly referencing the *Sony* Betamax decision, in which the Supreme Court held consumer copying for time-shifting to be fair use, and the distribution of video recorders therefore not contributory infringement, the district court stated:

"It is manifestly apparent that the use of a radio/cassette player to record songs played over free radio does not threaten the market for copyrighted works as does the use of a recorder which stores songs from private radio broadcasts on a subscription fee basis. Finding that this conduct is not protected under the AHRA is consistent with the fundamental tenet of copyright law that 'all who derive value from a copyrighted work should pay for that use.'"

## Quick Updates

### User Manuals Were Insufficient Evidence of Induced Infringement

Instruction manuals teaching the steps of a claimed method patent in isolation were recently held to be insufficient evidence of direct infringement to support a claim for inducing infringement. *E-Pass Technologies, Inc. v. 3COM Corp.*, Case No. 06-1356 (Fed. Cir. Jan. 12, 2007).

The plaintiff, E-Pass, sued various defendants for inducing infringement of a method claim directed to providing a method and device for substituting a single, electronic multifunction card for multiple credit cards. The defendants included makers of personal digital assistant (PDA) products including the PalmPilot®. Granting summary judgment of noninfringement, the district court held that E-Pass failed to adduce evidence that any of the defendants or their customers had directly infringed by practicing all the steps of the claimed method. Hence, E-Pass could not prove liability for induced infringement.

Affirming summary judgment of noninfringement, the Federal Circuit agreed that excerpts from product manuals for the accused devices were insufficient to establish direct infringement. First, none of the excerpts E-Pass relied on taught each step of the claimed method together. Nor did

they taught each step of the claimed method practicing the steps in the sequential order required by the method claim. Further, the PDA devices could be used for a variety of purposes and in a variety of noninfringing ways, a fact the court relied on to distinguish *Moleculon Research Corp. v. CBS, Inc.*, 793 F.2d 1261 (Fed. Cir. 1986), which held that the distributor of a Rubik's Cube-like puzzle induced infringement of a method claim on the protocol for solving such a puzzle by disseminating instruction sheets with the puzzle solution. Thus, the court held that it was "too speculative a leap to conclude that any customer actually performed the claimed method."

### Court Gives Employers New Method of Stopping Unauthorized Employee Access to Confidential and Proprietary Information

Employers now have another option for punishing employees for unauthorized taking of employer information. Employers can sue employees under the Computer Fraud and Abuse Act (CFAA) 18 U.S.C. § 1030 for unauthorized access of information on the employer's computers, which does not require proof of actual trade secret misappropriation. However, the employer may risk a defamation claim when discussing such unauthorized access claims outside of the company.

On November 22, 2006, in *Fiber Systems International, Inc. v. Roehrs*, 470 F.3d 1150 (5th Cir. 2006), the Fifth Circuit Court of Appeals ruled that an employer can bring a civil action against an employee under the CFAA, § 1030(a)(4), which prohibits knowing and unauthorized access of a protected computer with intent to defraud, if the conduct furthers the intended fraud and if the violator obtains anything of value.

The lawsuit arose from the struggle for control of Fiber Systems International, Inc. (FSI). The ownership dispute ended with Michael Roehrs buying out the minority owners' stake in the company, becoming executive chairman, and terminating employment of his brother, Daniel Roehrs, and the other defendants, who were officers and directors of FSI. In 2004, FSI sued the former employees, alleging that defendants violated the CFAA when leaving the company, taking with them confidential and proprietary information from FSI's computers. Defendants filed a defamation counterclaim alleging FSI falsely called them thieves from FSI's computers. While the jury found that three of the

defendants violated § 1030(a)(4) of the CFAA, entitling FSI to \$36,000 in damages, the district court entered a take-nothing judgment, holding that § 1030 does not create a civil cause of action for § (a)(4) violations. In addition, the jury awarded the defendants damages for the defamation action.

In FSI's appeal, the Fifth Circuit overturned the district court's take-nothing judgment, holding that § 1030(g) of the CFAA permits civil actions by any person suffering damage or loss under § 1030 as a whole, including under § 1030(a)(4). The jury found that FSI suffered a loss of \$36,000, which far exceeded the \$5,000 loss requirement for bringing such a claim.

The court further found that the district court's dismissal of FSI's claim for an injunction was proper because the CFAA allows injunctions only against ongoing and future unauthorized access. FSI could not be threatened by future harm from defendants' trade secret theft since the jury found that no trade secrets actually were stolen.

Regarding the defamation claim, FSI argued that the jury's finding of a § 1030 violation was equivalent to a finding that defendants were thieves, so FSI's statement that defendants were thieves was true and thus nondefamatory. However, the court explained that unauthorized access that results in obtaining something of value under § 1030, of which defendants were found guilty, does not require that the valuable thing obtained be a trade secret or even something stolen. The value obtained might be, *e.g.*, temporary use and possession of hardware.

Thus, while employers can sue employees for obtaining information under the CFAA without having to provide trade secret theft, employers still must be cautious not to refer to former employees as "thieves" in so doing.

### **Industry Regulation by Federal Government Impacts Whether a Trademark is "Used in Commerce" for Priority Purposes**

In a recent decision, *CreArgi, Inc. v. USANA Health Sciences*, Case No. 05-125305 (9th Cir. Jan. 17, 2007), the Ninth Circuit highlighted special considerations that companies in government-regulated industries must take into account when seeking trademark protection. Although trademark rights are typically established by use of a mark in commerce, the court in *CreArgi* followed

the lead of the Trademark Trial and Appeals Board in holding that such use in commerce must be "lawful."

In *CreArgi*, the court affirmed the dismissal of plaintiff's trademark infringement suit after determining that it had not established priority of use. The plaintiff, a pharmaceutical company, began selling a new product under the name "Olivenol" in the spring of 2001. More than a year later, the defendant filed an intent-to-use application to begin selling a series of nutritional supplements under the name "Olivol." Nevertheless, the court determined that the plaintiff did not have priority because at all times prior to the defendant's priority date, the plaintiff's labels failed to comply with the labeling requirements of the Food, Drug, and Cosmetic Act by erroneously but unintentionally misstating the amount of the drug's active ingredient.

Although this case was decided in the context of pharmaceuticals, the court's holding has ramifications for any government-regulated industry. A similar rule has been applied in the context of a bank's use of a service mark that did not comply with federal banking statutes, and also may apply, for example, to website operators whose content requires compliance with federal statutes, such as 18 U.S.C. § 2257. *CreArgi* also serves as an effective reminder that "use in commerce" is a term of art in trademark law and does not necessarily encompass activities that might otherwise appear sufficient to establish trademark rights.

Government regulations commonly include their own enforcement provisions that encourage compliance with their terms. However, the potential trademark effects of noncompliance may be lessened by filing an intent-to-use application in advance of the first use of a mark. As long as the proposed mark is otherwise registrable, and as long as the applicant makes a (lawful) use in commerce within the time set forth in the statute (up to three years in appropriate circumstances), an applicant will have established a priority date as of the date of the filing of the application—potentially rendering moot imperfect uses of a mark.



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